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UNITED STATES GENERAL ACCOUNTING OFFICE
REGIONAL OFFICE
8112 FEDERAL OFFICE BUILDING
FIFTH AND MAIN STREETS
CINCINNATI, OHIO 45202

NOV 24 1971

Mr. W. S. Curley, Superintendent
Federal Prison Industries, Inc.
Department of Justice
Terre Haute, Indiana 47808

Dear Mr. Curley:

We have completed an examination of the [financial statements] of the Federal Prison Industries, Inc. (FPI), Terre Haute, Indiana for the fiscal year ended June 30, 1971. The examination was made pursuant to the Government Corporation Control Act (31 U.S.C. 841).

Our review, which was completed October 1, 1971, was made in accordance with generally accepted auditing standards and included such tests of accounting records and financial transactions as we considered necessary in view of the nature and volume of transactions and the effectiveness of internal controls.

We observed that there was a need to revise certain accounting and other practices which are within your authority and responsibility. These matters are discussed below.

NEED FOR IMPROVEMENT IN
ACCOUNTING FOR INVENTORY

At the time of our review inadequate control over inventories was pronounced. We found that (1) standard procedures set out in the FPI Accounting Manual were not followed when material was requisitioned from the stockroom; (2) obsolete or excess materials and supplies were charged to production a little at a time rather than reported as excess property; (3) the moving average value of materials and supplies was not always computed after receipt of additional quantities; (4) the inventory contained many inactive items; and (5) variances existed for 30 of 42 items of materials or supplies included in our test counts.

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Requisition procedures

The FPI Accounting Manual states that raw materials and supplies shall be issued only upon receipt of a storeroom requisition, properly drawn, originating with the officer having authority to requisition such materials. A memorandum requisition may be used pending the submission of the storeroom requisition for raw materials or supplies and all items shall be receipted for, on the form, at the time of receipt by the person receiving the materials from the storeroom.

We were informed by the storeroom clerk that he prepared most requisitions, and this statement was supported by FPI employees. In addition, the clerk prepared some requisitions to enable him to make adjustments for differences noted between the storeroom bin cards and actual count. In these instances the procedure used was: (1) when a stock shortage was discovered a requisition was prepared to charge out the difference to production, and (2) when a stock overage was discovered the stock was issued to production without a requisition.

Obsolete or excess inventory

We noted seven items of obsolete or excess inventory, originally costing about \$28,000, which were charged to production a little at a time rather than reported to the Washington office as excess to local needs or written off as worthless inventory. Some of the inventory items were discarded and others remained in the storage warehouse at the time of our review. Examples noted included:

1. Tybon Resin #5657, Glass Binder (PTR-1) - Nine drums valued at \$933.59 spoiled and were charged to production, one bad drum with each good drum issued.
2. Steel wire inserts (PI-3) - Inserts valued at \$2,331.67 were being charged to fiscal year 1972 production costs although they were no longer required to manufacture the sales product which was plastic trays.
3. Adapters, reversible (CS-26) - Type II duffel bag adapters, 80,000 units, valued at \$10,776, were charged to type I duffel bag production during fiscal year 1971. Also, 86,580 units, valued at \$11,675 were charged to type I duffel bag production during fiscal year 1972. These adapters were being stored in a warehouse at the time of our review.

Moving average valuation

Standard procedure for using a moving average inventory valuation requires recomputation of the unit price after each receipt of material. We found that the unit price was not always computed after receipt of material and in some instances the computation of the moving average was incorrect. The moving averages were computed intermittently; however, by not recomputing the unit prices after each receipt, the value of material charged to production was incorrectly stated.

Inactive items

We noted many items of materials or supplies which were inactive. Many of these items may be obsolete or excess to local needs and therefore, inflate the inventory valuation. Examples noted included:

| <u>Item and stock number</u> | <u>Last issue</u> | <u>Quantity on hand</u> | <u>Dollar Value</u> |
|------------------------------|-------------------|-------------------------|---------------------|
| Grommets, type 3 (CS-9) | June 1967 | 4,530 | \$10,240 |
| Nylon mesh, style 22 (CS-20) | April 1969 | 1,606 yds. | 964 |
| Tape, textile (CS-6) | March 1969 | 220 rolls | 275 |
| Chrome, blue black (7-D-511) | December 1968 | 68,875 lbs. | 868 |
| Spindle oil (3-0-20) | November 1969 | 165 gal. | 89 |
| Ties, wire (3-T-166) | September 1966 | 25,000 | 72 |

Test counts

We made test counts of 42 items of materials or supplies valued at about \$150,000. We noted differences on 30 of the 42 items. Overages discovered amounted to about \$7,500 and shortages amounted to about \$10,000. We noted that an inventory count was difficult and time consuming because (1) the stock for all three factories was mixed together, (2) some items were in more than one location, and (3) often only the warehouse personnel could locate the stock.

Conclusion

In our opinion the poor control over inventories was due primarily to improper supervision since the FPI Accounting Manual sets out adequate control procedures from receipt through storage and issue. We suggest that the responsibility of each supervisor be emphasized to ensure that (1) proper requisition procedures are followed, (2) only required materials or supplies are charged to production, (3) inventory values are properly computed, and (4) inactive inventory items are identified and reported as excess to local needs on a timely basis.

We further suggest that the inventory of each factory be segregated, locator cards prepared, and where possible the stock number recorded on the boxes or drums to assist in taking of physical inventories and to improve control over receipts and issues.

NEED FOR IMPROVED CONTROL OVER FIXED ASSETS

We made a test count of 58 items of equipment shown on the fixed asset equipment cards of the woolen mill. We found two items of equipment which were being carried on the accounts at salvage value that had been cannibalized and junked. We also found that two new equipment items which had not been completely installed were being depreciated. The FPI accounting manual states that monthly depreciation charges should begin on the first day of the month following the month in which the item(s) are placed in use.

We also noted that between January 1967 and April 1970 the industries acquired 12 forklift trucks from Government surplus. Related transportation costs were \$1,604.48 but none of these trucks were capitalized at the time of receipt. The repair expense associated with these trucks indicates that they may have been beyond the economical repair point when acquired. During fiscal year 1971 and the first quarter of fiscal year 1972 the industries repaired and/or overhauled seven trucks at a cost of \$8,388. The industries capitalized \$5,841 and expensed \$2,547. The repairs were made by a commercial firm.

At the time of our audit three of the trucks repaired during the 15-month period were in the vocational training garage for additional repairs. Three others were in poor mechanical condition.

The vocational training supervisor, after reviewing the work statement/invoices from the commercial firm, stated the work could have been done at the industries vocational training garage with the possible exception of the conversions to an L.P. gas system. There would have been no charge, except for the parts, for which the commercial firm charged \$2,204. We noted that the salary of the supervisor and other expenses of the vocational training garage are paid by FPI.

We suggest that a complete inventory of machinery and equipment be made to identify all obsolete, unrepairable, or excess items and the accounting records adjusted accordingly. We also believe that economical repair points should be established for all machinery and equipment to prevent excess repair bills on overage equipment.

INCORRECT REPORTING OF
UNLIQUIDATED OBLIGATIONS

Section 1311 of Public Law 663, August 26, 1954, requires the FPI to submit a certified report to the Congress showing funds unobligated or unexpended as of June 30 of each fiscal year. The Terre Haute industries reported \$881,801 as unliquidated obligations at June 30, 1971.

We found that 45 of 151 undelivered purchase orders included in the report had actually been received and paid or received and included in accounts payable. The 45 orders totaled about \$14,000. We scanned the July 1971 receiving reports and found 13 instances where materials or supplies purchased on fiscal year 1971 purchase orders were not included in the report. The 13 orders totaled \$10,418. We also noted a mathematical error on the report of \$8,199.

We were informed by your staff that the report was prepared by inmate personnel and that they could not explain the errors. We believe that the special interest of the Congress in accurate reports of obligations should be kept in mind at all times and that adequate supervisory review should be provided during preparation of the report.

OTHER MATTERS

The following items came to our attention during the audit:

1. The Terre Haute industries sold grommets valued at \$1,293.82 to the Atlanta FPI without obtaining approval of the Washington office as required by the accounting manual. Loss on the sale totaled \$1,223.73.

2. An \$800 royalty payment made to Herman Miller, Inc., was unearned because the chairs were manufactured without the patented interlocking units.

3. Tests of the industries civilian payroll disclosed two leave service computation date errors and errors on four retirement records (SF2806).

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We would appreciate your comments as to the final disposition of the matters discussed above. We wish to thank you for the cooperation and assistance provided our representatives during the examination.

Copies of this letter are being sent to the Assistant Attorney General for Administration, the Commissioner of Industries, and the Warden, U. S. Penitentiary, Terre Haute, Indiana.

Sincerely yours,



David P. Sorando
Regional Manager

cc/ Assistant Attorney General
for Administration
The Commissioner of Industries
Warden, U. S. Penitentiary,
Terre Haute, Indiana